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IN THE

Supreme Court of the United States

October Term, 1949

No. 617

COMMONWEALTH OF PENNSYLVANIA,
Petitioner

vs.

THE CURTIS PUBLISHING COMPANY,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA AND BRIEF IN SUPPORT THEREOF

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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1949

No.

Commonwealth of Pennsylvania,
Petitioner

vs.

The Curtis Publishing Company,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner respectfully prays that a writ of **certiorari** issue to review the judgment of the Supreme Court of Pennsylvania, reported in 363 Pa. 299 (1949), which affirmed a judgment of the Common Pleas Court of Dauphin County reported in 59 Dauph. 430 (1948) (R. 140a, 153a).

I. SUMMARY OF STATEMENT OF MATTER INVOLVED

Respondent, The Curtis Publishing Company of Pennsylvania, is a Pennsylvania corporation, and, during the year 1942, was engaged in business in the Commonwealth of Pennsylvania.

Pursuant to the Pennsylvania Corporate Net Income Tax Act of May 29, 1941, P. L. 62, Respondent, on April 5, 1943, filed its corporate net income tax return for the calendar year 1942 wherein the tax estimated by it to be due was "None", based upon its net income as returned to the Federal Government. Following an adjustment by the Federal Government of its Federal net income for the year 1942, Respondent filed with the Commonwealth of Pennsylvania a Report of Change which reported that its adjusted net income as returned to and ascertained by the Federal Government increased from $886,280.53 to $1,033,923.16.

Included in Respondent's changed net income as returned to and ascertained by the Federal Government was an item of $75,389.62, representing interest on United States obligations issued subsequent to March 1, 1941, subject to Federal income tax, following the enactment of the Federal Public Debt Act of February 19, 1941, Chapter 7, Section 4, 55 Stat. 9.

In arriving at Respondent's net income tax base for purposes of the state tax, the fiscal officers of the Commonwealth deducted from Respondent's reported Federal net income, as prescribed by the Pennsylvania statute, the amount of Federal taxes paid and the amount of dividends received by Respondent as owners of shares of stock in other corporations. The item of $75,389.62 representing interest on United States obligations issued after March 1, 1941, was not deducted from Respondent's net income as returned to and ascertained by the Federal Government. The allocation fractions prescribed by the Pennsylvania statute were then applied to the resultant net income tax base to arrive at Respondent's corporate net income tax liability to the Commonwealth in the amount of $6,367.67.

Respondent contends, and Petitioner denies, that by reason of the Commonwealth's refusal to deduct interest on United States obligations issued after March 1, 1941, from Respondent's tax base measured by net income as returned to and ascertained by the Federal Government, the Pennsylvania Corporate Net Income Tax Act of May 29, 1941, P. L. 62, has been applied in violation of Article VI, Clause 2, and Article I, Section 8, Clause 2, of the Constitution of the United States.

II. STATEMENT AS TO JURISDICTION

A. Basis upon which it is contended that the Supreme Court of the United States has jurisdiction on Writ of Certiorari to review the judgment in question.

The judgment of the Supreme Court of Pennsylvania, a review of which is sought by this petition for a writ of certiorari, was dated and filed on November 22, 1949. It is a final judgment in a suit in the highest court of the Commonwealth of Pennsylvania in which a decision in the suit could be had. In this suit, there was drawn in question the validity of a statute of the Commonwealth of Pennsylvania in its application to Respondent on the grounds of being repugnant to Article VI, Clause 2, and Article I, Section 8, Clause 2, of the Constitution of the United States. A decision on this case was necessary to the determination of the case, and the decision was against the validity of the statute.

B. Statutory provision and cases believed to sustain jurisdiction.

The statutory provision believed to sustain the jurisdiction of the Supreme Court of the United

States upon petition for review of the judgment in question on writ of certiorari is Title 28 United States Code, Section 1257 (3), Act of June 25, 1948, C. 646, 62 Stat. 869. Cases believed to sustain jurisdiction are **McGoldrick v. Gulf Oil Corp.**, 308 U. S. 545 (1939) and **Nelson (Rodewig) v. Sears, Roebuck and Co.**, 311 U. S. 630 (1940).

C. The statute of the Commonwealth of Pennsylvania, the validity of which is involved.

The statute of the Commonwealth of Pennsylvania which was held as applied to Respondent to be repugnant to Article I, Section 8, Clause 2, and Article VI, Clause 2, of the Constitution of the United States is the Act of May 29, 1941, P. L. 62, reenacting and amending the Act of May 16, 1935, P. L. 208. The following are the relevant provisions of this Act.

Section 3 of the said Act provides:

> "Every corporation shall be subject to, and shall pay for the privilege of doing business in this Commonwealth, or having capital or property employed or used in this Commonwealth * * * a State excise tax * * * at the rate of seven per centum per annum upon each dollar of net income of such cor-

porations during the calendar year(s) * * * one thousand nine hundred forty-two * * *."

Section 2 of the Act defines net income as follows:

"'Net Income.' 1. In case the entire business of the corporation is transacted within this Commonwealth, net income for the calendar year or fiscal year as returned to and ascertained by the Federal Government, subject, however, to any correction thereof, for fraud, evasion, or error as finally ascertained by the Federal Government: Provided, That additional deductions shall be allowed from net income on account of any Federal taxes paid during such calendar or fiscal year for the preceding calendar or fiscal year, or accrued during such calendar or fiscal year for such year, as the case may be, and on account of any dividends received from any other corporation: * * *

"2. In case the entire business of any corporation, other than a corporation engaged in doing business as an insurance or surety company, is not transacted within this Commonwealth, the tax imposed by this act shall be based upon such portion of the net income of such corporation for the fiscal or calendar year, as defined in clause one hereof, as may be determined by allocations and apportionment made as follows * * *"

Section 2 of the said Act then provides for the allocation or non-allocation of capital gains and for the computation of the taxable portion of the resultant net income by the application of a formula made up of three fractions consisting of tangible property, payroll and receipts, the elements of which are set forth in detail in the Act.

D. Date of the judgment sought to be reviewed and of petition for review on Writ of Certiorari.

The judgment of the Supreme Court of Pennsylvania sought to be reviewed was dated and filed on November 22, 1949.

This petition is presented within ninety days of that date.

E. Statement showing that the nature of the case and the rulings of the court were such as to bring the case within the jurisdictional provisions relied upon.

As set forth in Statement I, above, (Summary Statement of Matter Involved), the fiscal officers of the Commonwealth settled Respondent's corporate net income tax liability for the year 1942 at $6,367.67. In arriving at this settlement no deduction was allowed for interest received by Re-

spondent on United States obligations issued after March 1, 1941, since such interest was included in Respondent's net income as returned to and ascertained by the Federal Government for Federal tax purposes.

Respondent thereupon filed an appeal in the Court of Common Pleas of Dauphin County, Pennsylvania, in which it contended, inter alia, that the settlement of the tax, and the Act of May 29, 1941, P. L. 62, under the authority of which said settlement had been made, were repugnant to the Constitution of the United States, because:

1. The effect of the tax imposed as settled was to infringe upon the sovereignty of the United States in violation of Article VI, Clause 2, of the Constitution of the United States.

2. The effect of the tax imposed was to discriminate in favor of interest received from, and in favor of, obligations of the Commonwealth of Pennsylvania and its political subdivisions; and against the interest received from, and against the securities of the United States; and

3. The effect of the tax imposed was to burden, restrict, impede and interfere with the power of Congress to borrow money in violation of the provisions of Article I, Sec-

tion 8, Clause 2, of the Constitution of the United States.

The trial court determined the amount of tax owing by Respondent to be $2,549.01; sustained the contentions made by Respondent, and refused those of Petitioner made in denial thereof; and held that the Act of May 29, 1941, P. L. 62, as applied to Respondent by the Commonwealth's tax settlement violated Article I, Section 8, Clause 2, and Article VI, Clause 2, of the Constitution of the United States.

On appeal to the Supreme Court of Pennsylvania from the findings, conclusions, rulings and judgment of the trial court, Petitioner made the same contentions as before the trial court. In affirming the judgment of the trial court, the Supreme Court of Pennsylvania overruled each contention made by Petitioner and held the Act of May 29, 1941, P. L. 62, as applied to Respondent by the Commonwealth's tax settlement to be repugnant to and in violation of Article I, Section 8, Clause 2, and Article VI, Clause 2, of the Constitution of the United States.

F. The stage in the proceedings in the court of first instance and in the appellate court, in which the federal questions sought to be reviewed were raised; the method of raising them and the way in which they were passed upon by the court; the rulings of the court thereon to show that the case is brought within the statutory provisions believed to confer jurisdiction on this court.

The questions as stated above were raised by Respondent in the 11th, 12th and 14th paragraphs of its Appeal and Specification of Objections filed with the trial court (R. 7a, 8a) and more fully stated in Respondent's 1st, 3rd and 5th Requests to the trial court for Conclusions of Law (R. 99a, 100a, 101a) which read as follows:

> "1. A State tax which discriminates against United States securities is unconstitutional and void, as being in violation of Article VI, Clause 2, of the Constitution of the United States, which establishes the Constitution and the laws of the United States as the supreme law of the land, and as being in violation of Article I, Section 8, Clause 2, of said Constitution, which grants to Congress the power to borrow money."
>
> "3. The application which the Commonwealth of Pennsylvania has given the Cor-

porate Net Income Tax Act for the years 1941 and 1942, by which 'adjusted net income', as derived under the Federal corporation income tax return, is used as the base for computing the Pennsylvania corporate net income tax, results in such discrimination against United States securities as to render this application of the Act unconstitutional and void, because it operates to include interest received on United States securities issued on or after March 1, 1941, in the income subjected to the Pennsylvania tax, while interest on State and municipal securities is excluded from such income."

"5. A State tax measured by corporate net income which is computed by including interest on United States securities in the taxable income and by excluding interest on State and municipal securities and dividends on corporate shares from such income, discriminates against United States securities and is unconstitutional and void."

The same questions were raised by Petitioner in its 8th Request to the trial court for Conclusions of Law (R. 110a) as follows:

"(8) The inclusion of interest from obligations of the United States, issued after March 1, 1941, in the measure of the Pennsylvania Corporate Net Income Tax, is a valid exercise of the Commonwealth's right

to classify property for purposes of taxation and does not constitute unlawful discrimination against these securities in violation of either Article I, Section 8, Clause 2 or Article VI, Clause 2 of the Federal Constitution."

Petitioner urged these questions in its exceptions to the rulings on conclusions of law, conclusions of law, opinion and judgment nisi of the trial court (R. 141a) and in its assignments of error, brief and argument in the Supreme Court of Pennsylvania.

Respondent's above Requests for Conclusions of Law were specifically affirmed and Petitioner's Requests specifically refused by the trial court.

The tax statute as applied to Respondent was held to be in violation of Article I, Section 8, Clause 2, and Article VI, Clause 2, of the Constitution of the United States by the trial court in its opinion (R. 111a, 134a, 135a) in its affirmance of Conclusions of Law as requested by Respondent (R. 99a, 100a, 101a), in its refusal to find the Conclusions of Law requested by Petitioner (R. 110a) and in overruling Petitioner's exceptions to its conclusions of law, its opinion and judgment nisi (R. 153a); and by the Supreme Court of Pennsylvania in its opinion affirming the judgment of the trial court.

III. QUESTION PRESENTED

Where the Petitioner's fiscal officers settled Respondent's corporate net income tax account for the year 1942 upon a tax base measured by Respondent's "net income as returned to, and ascertained by the Federal Government" under the express provisions of the Act of May 16, 1935, P. L. 208, as reenacted and amended by the Act of May 29, 1941, P. L. 62, and where, in the absence of any statutory provision permitting or requiring it, neither the Respondent nor the fiscal officers deducted from such measure interest returned to the Federal Government as income on United States obligations issued after March 1, 1941, and owned by Respondent, does the settlement as made violate the Constitution of the United States, and particularly Article VI, Clause 2, and/or Article I, Section 8, Clause 2, thereof?

IV. REASONS RELIED UPON FOR THE ALLOWANCE OF A WRIT OF CERTIORARI

In denying the power of the Commonwealth of Pennsylvania to impose a corporate net income tax upon Respondent measured by its net income as returned to and ascertained by the Federal Government without deduction of interest on United States obligations issued after March 1, 1941, as being in violation of the Constitution of the United States, and particularly Article I, Section 8, Clause 2, and Article VI, Clause 2, thereof, the Supreme Court of Pennsylvania has decided a federal question of substance and importance which has not heretofore been determined by this Court, and in a manner probably not in accord with the applicable decisions of this Court, as indicated in the Brief in Support of Petition for Writ of Certiorari annexed hereto.

At least two other states have enacted corporate net income tax statutes with provisions similar to the Pennsylvania Corporate Net Income Tax Act—Massachusetts (General Laws C. 63, as amended, Section 30), and Vermont (Vermont Statutes, Revision of 1947, No. 15, Section 1).

V. PRAYER

Wherefore, your Petitioner prays that a Writ of Certiorari be issued out of and under the seal of this Court directed to the Supreme Court of Pennsylvania, commanding that Court to certify and send to this Court, on a day certain to be named therein, a full and complete transcript of the record of the proceedings in case numbered 7, May Term, 1949, entitled on its docket "Commonwealth of Pennsylvania, Appellant v. The Curtis Publishing Company" to the end that the cause may be reviewed and determined by this Court as provided by law, that the judgment may be reversed, and for such other and further relief as may be appropriately granted in the premises.

Respectfully submitted,
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State Capitol,
Harrisburg, Pennsylvania.

IN THE
SUPREME COURT OF THE UNITED
STATES

October Term, 1949 **No.**

Commonwealth of Pennsylvania,
Petitioner

vs.

The Curtis Publishing Company,
Respondent

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The petition for writ of certiorari refers to the opinions of the Dauphin County Court and the Pennsylvania Supreme Court, the grounds upon which jurisdiction is invoked, and the pertinent constitutional and statutory provisions. It also sets forth a summary statement of the matter involved and states the questions presented.

I. STATEMENT OF THE CASE

There is no dispute as to the facts in the case which have been stipulated (Stipulation of Facts 44a-55a).

The Curtis Publishing Company of Pennsylvania was incorporated under the laws of the Commonwealth of Pennsylvania in December, 1921, and during the year 1942 was engaged in business subject to corporate net income tax by the Commonwealth under the provisions of the Corporate Net Income Tax Act of May 16, 1935, P. L. 208, as reenacted and amended by the Act of May 29, 1941, P. L. 62 (44a, 45a).

On April 5, 1943, the company filed its corporate net income tax return for the calendar year 1942 wherein the tax estimated by it to be due was "None", based upon the net income as returned to the Federal Government. In this report the taxpayer took no deduction on account of interest received on United States obligations issued after March 1, 1941 (Commonwealth's Exhibit No. 1, 154a).

On November 3, 1943, the company filed with the Department of Revenue a Report of Change of net income for 1942, wherein corporate net

income tax was estimated by it to be due the Commonwealth in the amount of $6,066.03, which sum was paid to the Department of Revenue (Commonwealth's Exhibit No. 2, 155a).

This Report of Change filed by the taxpayer with the Department of Revenue reported that the company's adjusted net income as returned to, and ascertained by the Federal Government increased from $886,280.53 to $1,033,923.16 (Commonwealth's Exhibit No. 2, 155a).

The company's net income, subject to allocation by the use of the appropriate fractions, was reported to be in the amount of $125,713.37. This figure was computed by the taxpayer as follows:

"Adjusted net income per 'Report of Change' in income filed November 3, 1943, on which the settlement appealed from is based		$ 1,033,923.16
Deductions allowed by Pennsylvania Corporate Net Income Tax Act:		
Federal taxes	$149,644.11	
Dividends	758,565.68	908,209.79
Net income tax base		$ 125,713.37"

(Commonwealth's Exhibit No. 2, 155a).

Included in the taxpayer's net income as returned to and ascertained by the Federal Gov-

ernment was an item in the amount of $75,389.62, representing interest on United States obligations issued subsequent to March 1, 1941 (Commonwealth's Exhibit No. 1, 154a). In the Report of Change, the taxpayer took no deduction on account of this interest received on United States obligations issued after March 1, 1941 (Commonwealth's Exhibit No. 2, 155a).

On December 27, 1945, the Department of Revenue settled the company's 1942 corporate net income tax, which settlement was approved by the Department of the Auditor General on December 27, 1945. This settlement, based upon facts appearing in both the original report and the Report of Change, determined the taxpayer's tax liability to be in the amount of $6,367.67 (Commonwealth's Exhibit No. 1, 154a). The difference between $6,006.03, as reported by the taxpayer, and $6,367.67, settled by the fiscal officers, was due to a correction in the gross receipts fraction, and is not here in question (51a).

In this settlement of the company's net income tax base for purposes of the Pennsylvania corporate net income tax, the fiscal officers of the Commonwealth did not deduct the item of $75,389.62, representing interest on United States securities issued after March 1, 1941, from the company's net income as returned to, and ascertained by the Federal Government (Commonwealth's Exhibit No. 1, 154a).

On February 26, 1946, the taxpayer filed a Petition for Resettlement with the Department of Revenue, and that petition was refused on May 3, 1946 (18a, 42a).

On June 17, 1946, the taxpayer filed a Petition for Review with the Board of Finance and Revenue, and that petition was refused on July 11, 1946 (19a, 42a).

On ~~July 17~~ Aug 2, 1946, the taxpayer filed ~~a Petition~~ its ap- peal in the Court of Common Pleas of Dauphin County from the settlement and action of the Board of Finance and Revenue (3a, 88a). A stipulation was filed waiving a jury trial as provided by the Act of 1874, P. L. 109 (32a, 88a). At the hearing testimony was taken and submitted in the form of an agreed stipulation of facts (37a, 44a). Argument was heard and the court in due course rendered its decision, and entered a judgment nisi in favor of the taxpayer in the amount of $3,818.66 (140a). Exceptions to the lower court's rulings on requests for conclusions of law, the conclusions of law, and the judgment nisi were duly filed by the Commonwealth (141a). The court by an order overruled each of the Commonwealth's exceptions and directed that judgment be entered in favor of the taxpayer and in accordance with its prior opinion (153a). Upon appeal to the Supreme Court of Pennsylvania, the judgment of the lower court was affirmed.

II. ARGUMENT

1. The nature of the Corporate Net Income Tax Act of May 29, 1941, P. L. 62, as determined by the court of last resort in Pennsylvania.

Section 3 of the Corporate Net Income Tax Act of May 29, 1941, P. L. 62, reenacting and amending the Act of May 16, 1935, P. L. 208, provides:

> "Every corporation shall be subject to, and shall pay **for the privilege of doing business in this Commonwealth,** or having capital or property employed or used in this Commonwealth * * * **a State excise tax** * * * at the rate of seven per centum per annum upon each dollar of the **net income** of such corporations during the calendar year(s) * * * one thousand nine hundred forty-two * * *." (Boldface ours)

It is now well established under the decisions of the Supreme Court construing the nature of the Pennsylvania corporate net income tax, that it is **an excise tax for the privilege of doing business in the Commonwealth measured by the net income as returned to and ascertained by the Federal Government.**

Turco Paint & Varnish Co. v. Kalodner, 320 Pa. 421, 423, 429 (1936);

Commonwealth v. Warner Bros. Theatres, Inc., 345 Pa. 270, 271 (1942);

Commonwealth v. Bayuk Cigars, Inc., 345 Pa. 348, 350, 351 (1942);

Commonwealth v. Electrolux Corporation, 59 Dauph. 412 (1948), affirmed per curiam, 362 Pa. 333 (1949).

Even the most cursory examination of the cited cases makes it abundantly clear that the Pennsylvania corporate net income tax is (1) neither a property tax on net income; (2) nor a tax on the privilege of investing in United States obligations; (3) nor a tax on the privilege of doing business measured exclusively by income from investments in United States obligations.

The true nature of the tax is precisely described by the Supreme Court of Pennsylvania in Commonwealth v. Warner Bros. Theatres, Inc., supra, at pages 271, 272, in the following distinguishing language:

> "At the outset, it is to be observed that we are not considering an income tax, but an excise tax for the privilege of doing business in the Commonwealth, based upon net income as returned to and ascertained by the Federal Government. When this situation

is borne in mind, the doubts as to the legality of the tax suggested by appellant disappear."

This principle was recognized by the lower court even in the instant case, 59 Dauph. 430, at page 439 (126a), in the following language:

> "It must not be overlooked that under the Pennsylvania Corporate Net Income Tax Act there is no direct tax imposed for the privilege of doing business in Pennsylvania as measured by the net income." (Citing cases).

It was also recognized in the instant case by the Supreme Court of Pennsylvania in its decision affirming the holding of the lower court, 363 Pa. 299, 312.

Section 2 of the Act defines net income as follows:

> " 'Net Income.' 1. In case the entire business of the corporation is transacted within this Commonwealth, net income for the calendar year or fiscal year as returned to, and ascertained by the Federal Government, subject, however, to any correction thereof, for fraud, evasion, or error as finally ascertained by the Federal Government: Provided, That additional deductions shall be allowed from net income on account of any

> Federal taxes paid during such calendar or fiscal year for the preceding calendar or fiscal year, or accrued during such calendar or fiscal year for such year, as the case may be, and on account of any dividends received from any other corporation: * * *
>
> "2. In case the entire business of any corporation, other than a corporation engaged in doing business as an insurance or surety company, is not transacted within this Commonwealth, the tax imposed by this act shall be based upon such portion of the net income of such corporation for the fiscal or calendar year, as defined in clause one hereof, as may be determined by allocations and apportionments made as follows: * * *."

From a reading of the plain language of Section 2, it is evident that the net income as ascertained by the Federal Government is the base upon which the Pennsylvania tax is measured; that as a base it is unvarying; and, that the Pennsylvania act "only takes the net income fixed by it (the Federal Government) as the base for the excise privilege tax levied by the Commonwealth": Commonwealth v. Warner Bros. Theatres, Inc., supra, page 272.

Such was the plain and proper construction placed upon Section 2 by the Supreme Court of Pennsylvania in the last cited case. There the

Court stated at pages 271, 272, (repeating in part and continuing with the excerpt previously quoted):

> "At the outset, it is to be observed that we are not considering an income tax, but an excise tax for the privilege of doing business in the Commonwealth, based upon net income as returned to and ascertained by the Federal Government. When this situation is borne in mind, the doubts as to the legality of the tax suggested by appellant disappear. Net income as ascertained is the base upon which the tax is measured, not the tax itself. **How it was fixed by the Federal authorities is of no concern to the taxing officers of the Commonwealth nor to its statute.** The rate of the income tax may vary, or the method of its computation, but as a base, it is unvarying." (Boldface ours)

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2. A corporate franchise or privilege tax measured by a base which includes in part interest on United States obligations does not violate either Article VI, Clause 2, and/or Article I, Section 8, Clause 2, of the United States Constitution.

A basic question involved in this petition concerns the extending of the field within which the

doctrine of intergovernmental tax immunity may be given operative effect.

The doctrine of intergovernmental tax immunity rests ultimately upon implication, and not upon explicit provisions of the Constitution. Both early and recent cases of the Supreme Court of the United States have recognized that the superstructure of intergovernmental tax immunity is constructed upon the foundation stone of implication.

Early acknowledgment of this proposition was made in the case of **Collector v. Day,** 11 Wall. 113 (1871), wherein the Supreme Court of the United States said, at page 127:

> "* * * It is admitted that there is no express provision in the Constitution that prohibits the general government from taxing the means and instrumentalities of the states, nor is there any prohibiting the states from taxing the means and instrumentalities of that government. In both cases the exemption rests upon necessary implication, and is upheld by the great law of self preservation; * * *"

A more recent recognition was given this proposition in the concurring opinion of Mr. Justice Frankfurter in **Graves v. N. Y. ex rel. O'Keefe,** 306 U. S. 466 (1939), stating at page 488:

> "For one hundred and twenty years this Court has been concerned with claims of immunity from taxes imposed by one authority in our dual system of government because of the taxpayer's relation to the other. The basis for the Court's intervention in this field has not been any explicit provision of the Constitution. * * *"

In the present case we are concerned with one side of the coin of reciprocal government immunity—the implied restriction upon the taxing powers of a State in so far as it touches upon certain obligations of the United States or the interest therefrom.

Whatever immunity from State taxation is extended to United States obligations, or interest therefrom, rests upon implication derived from Article VI, Clause 2, and Article I, Section 8, Clause 2, of the Constitution of the United States. The former establishes the constitution and the laws of the United States as the supreme law of the land; the latter provides that "Congress shall have power * * * to borrow money on the credit of the United States."

The immunity that has been implied from these provisions of the Constitution has been consistently applied to those cases where a State sought to impose a **direct** tax upon United States obligations or the interest derived therefrom.

But on no occasion has this immunity been over extended to cases involving a bona fide State franchise or privilege tax which included in its measure, in part at least, otherwise exempt United States obligations or interest therefrom.

The distinction between a direct tax upon United States obligations or interest therefrom and an excise or privilege tax which merely involves such obligations or interest in the measure has been made even in cases involving Federal taxes. See **Flint v. Stone Tracy Co.**, 220 U. S. 107, 171 (1911), involving a Federal corporate excise tax measured by net income including United States bonds; **Phipps v. Commissioner of Internal Revenue,** 91 F. (2d) 627 (1937), involving a Federal gift tax and its application to United States bonds.

The Supreme Court of the United States sustained as valid State corporate franchise or privilege taxes measured by net income which includes interest on United States obligations:

Home Ins. Co. v. New York, 134 U. S. 594, 10 S. Ct. 593, 33 L. Ed. 1025 (1890);

Educational Films Corp. v. Ward, 282 U. S. 379 (1931);

Tradesmen's National Bank v. Oklahoma Tax Comm., 309 U. S. 560, 60 S. Ct. 688, 84 L. Ed. 947 (1940);

Cf. also **Pacific Co. v. Johnson,** 285 U. S. 480, 490 (1932);

People of State of New York ex rel. Northern Finance Corp. v. Lynch, 290 U. S. 601 (1933);

N. J. Realty v. Div. of Tax Appeal, U. S. , 10 U. S. Supreme Court Bulletin, 463, 470 and Footnote 6 (February 6, 1950);

Also **31 Ops. Att'y Gen. (U. S.)** 125, 126 127.

It is now settled beyond question that the construction placed by the Supreme Court of Pennsylvania upon the Corporate Net Income Tax Act of May 16, 1935, P. L. 208, as amended, has determined the tax to be, not a tax imposed on property, but an "excise tax for the privilege of doing business in the Commonwealth, based upon net income as returned to and ascertained by the Federal Government", wherein the "net income as ascertained is the base upon which the tax is measured not the tax itself": Commonwealth v. Warner Bros. Theatres, Inc., supra. Cf. also, Turco Paint and Varnish Co. v. Kalodner, supra.

The taxpayer's contentions are basically founded upon an over-extension of the doctrine of reciprocal governmental immunity. Not being founded expressly upon provisions of the

Constitution of the United States, the doctrine rests upon judicial implication. The current attitude of the Supreme Court of the United States, if we may presume to appreciate it, would appear to reflect a definite waning of implied governmental immunities in view of current interrelationship between the functions of the Federal Government and those of the States.

Graves v. N. Y. ex rel. O'Keefe, supra, involved the New York income tax imposed on the receipt of salary by a resident of New York as an examining attorney for the Federal Home Owners' Loan Corporation. The Court, in rejecting the taxpayer's claim for refund, stated at page 486:

> "In no case is there basis for **the assumption** that any such tangible or certain economic burden is imposed on the government concerned as would justify a court's declaring that the taxpayer is clothed with the implied constitutional tax immunity of the government by which he is employed. That assumption made in Collector v, Day, supra, and in New York ex rel. Rogers v. Graves, supra, is contrary to the reasoning and to the conclusions reached in the Gerhardt case and in Metcalf & Eddy v. Mitchell, supra; Group No. 1 Oil Corp. v. Bass,

> 283 U. S. 279; James v. Dravo Contracting Co., supra; Helvering v. Mountain Producers Corp., supra; McLoughlin v. Commissioner, 303 U. S. 218. **In their light the assumption can no longer be made.** Collector v. Day, supra, and New York ex rel. Rogers v. Graves, supra, are overruled so far as they recognize an implied constitutional immunity from income taxation of the salaries of officers or employees of the national or a state government or their instrumentalities." (Boldface ours)

If, in following the Supreme Court of the United States, **no assumption** were to be made in the instant case of a tangible or economic burden on the Federal Government's borrowing powers, there would be equal justification in refusing to declare that "the taxpayer is clothed with the implied constitutional tax immunity of the government" in whose obligations he has invested. Particularly so where, as here, no proof whatever was offered or produced to establish such burden.

Again, in **Oklahoma Tax Commission v. Texas Co.**, 336 U. S. 342 (1949), the Supreme Court, holding that a lessee of mineral rights and restricted Indian lands is not immunized against payment of State gross production

taxes and State excise taxes on petroleum produced from such lands, said at page 352:

> "It is true that this Court's more recent pronouncements have beaten a fairly large retreat from its formerly prevailing ideas concerning the breadth of so-called intergovernmental immunities from taxation, a retreat which has run in both directions—to restrict the scope of immunity of private persons seeking to clothe themselves with governmental character from both federal and state taxation. The history of the immunity, by and large in both aspects, represents a rising or expanding curve, tapering off into a falling or contracting one."

And further on page 365:

> "* * * True intergovernmental immunity remains for the most part. But, so far as concerns private persons claiming immunity for their ordinary business operations (even though in connection with governmental activities), no implied constitutional immunity can rest on the merely hypothetical interferences with governmental functions here asserted to sustain exemption. * * *"

3 The Pennsylvania corporate net income tax measured by "net income as returned to and ascertained by the Federal Government" is neither "discriminatory", "hostile" nor "burdensome".

It is the taxpayer's contention that the Pennsylvania Corporate Net Income Tax Act of May 29, 1941, P. L. 62, as applied by the fiscal officers of the Commonwealth violates Article I, Section 8, Clause 2, of the Constitution of the United States (providing that "Congress shall have power * * * to borrow money"), and Article VI, Clause 2 (establishing the Constitution of the United States the supreme law of the land) because the Pennsylvania Act is discriminatory.

The contention is based on the ground that the measure of the tax takes as its base the "net income as returned to and ascertained by the Federal Government" which net income as ascertained by the Federal Government includes interest on United States obligations issued after March 1, 1941, but does not include interest on State and municipal obligations.

The most minute reading of the Act fails to reveal any mention of State or municipal obligations; nor is any reference made to interest derived therefrom; nor, for that matter, is any

mention or reference made to United States obligations or interest derived therefrom. It is obvious that there is at least no express statutory discrimination among such obligations on the face of the Pennsylvania Act. It is likewise apparent that had the Legislature intended to give special treatment to the interest on a particular class of obligations they well knew how to provide for it. However, the Act itself, as stated in Commonwealth v. Warner Bros. Theatres, Inc., supra, "only takes the net income fixed by it (the Federal Government) as the base for the excise privilege tax levied by the Commonwealth". There is nothing in the language of the Act to require or authorize the fiscal officers of the Commonwealth to make an adjustment of the net income by deducting from the Federal base (as Respondent would have them do) the interest derived from certain United States obligations.

Secondly, the entire record may be searched from beginning to end, yet nowhere does it appear that any evidence was adduced, or even offered, to prove the existence of **actual or factual discrimination** as between United States obligations on the one hand and State and municipal obligations on the other. The burden of establishing the facts to support the allegation of discrimination rests squarely upon the taxpayer:

Willcuts v. Bunn, 282 U. S. 216, 230, 231 (1931);

Welch v. Henry, 305 U. S. 134, 146 (1938);

Commonwealth v. Union National Bank of Reading, 51 Dauph. 362, 370, 371, 373, 374 (1940);

Commonwealth v. City National Bank, Philadelphia, Pa., 52 Dauph. 87, 101, 104 (1941).

In reality the taxpayer's complaint is based on the fact that the taxing officers **did settle** the tax precisely as required on the very face of the report. The company's contention actually asserts that they should not have done so, but should have interpolated an adjustment of net income by way of a deduction of interest on certain United States bonds, despite the absence of any statutory authority to do so. Thus, the alleged discrimination is not bottomed on the settlement of the tax on the face of the tax report, but on the omission of the fiscal officers to make an additional adjustment not provided for either by the Act or the form of the tax report itself, nor, for that matter even claimed in the taxpayer's own tax reports (Commonwealth's Exhibits Nos. 1, 2, 154a, 155a).

The contention of the taxpayer that the settlement of tax in the instant case had the effect

of discriminating against its ownership of United States obligations, is fully answered even by very early decisions of the Supreme Court of the United States.

Thus, in Home Insurance Co. v. New York, supra, page 612, it was said:

> "This doctrine of the taxability of the franchises of a corporation **without reference to the character of the property in which its capital stock or its deposits are invested** is sustained by the judgments in Society for Savings v. Coite, 6 Wall. 594, and Provident Institution v. Massachusetts, 6 Wall. 611, which were before this court at December Term, 1867. * * *"
> (Boldface ours)

And in **Society for Savings v. Coite,** 6 Wall. 594, 18 L. ed. 907 (1868), pages 606, 607, it was said:

> "Nothing can be more certain in legal decision than that the privileges and franchises of a private corporation, all trades and avocations by which the citizens acquire a livelihood, may be taxed by a state for the support of the state government. Authority to that effect resides in the state independent of the Federal government, **and is wholly unaffected by the fact that**

the corporation or individual has or has not made investment in Federal securities. Osborn v. U. S. Bank, 9 Wheat. 859." (Boldface ours)

Hence the choice and character of taxpayer's investments are entirely irrelevant where the tax in issue is one imposed for the privilege of doing business and not upon the property or income as such.

All corporations in like circumstances to the taxpayer in the instant case are given like treatment taxwise: Turco Paint and Varnish Co. v. Kalodner, supra.

To contend, as the taxpayer does, that the alleged discriminatory effect of the Pennsylvania Act is derivative from the adoption of the Federal base not only seeks to account for a charge which it has failed in fact to prove, but also carries with it the admission that the discrimination, if any, is not the result of any "unfriendly", "hostile", or "invidious" legislation on the part of the Commonwealth of Pennsylvania.

The Corporate Net Income Tax Act of May 16, 1935, P. L. 208, and its various reenactments and amendments, including the Act of May 29, 1941, P. L. 62, were not passed as acts of unfriendly discrimination. For only since the Public Debt Act of 1941 were these Federal obli-

gations and income therefrom made subject to Federal taxation.

Any burden to the taxpayer by reason of receiving income from United States obligations issued after March 1, 1941, is, in so far as the State legislation is concerned, purely casual and incidental.

In this connection the principle of law is established by Educational Films Corp. v. Ward, supra, 388, 389; Pacific Co. v. Johnson, supra, 493-495; Tradesmen's National Bank of Oklahoma City v. Oklahoma Tax Comm., supra, 564-566.

In the Pennsylvania Corporate Net Income Tax Act there is **not**, as there was in **Miller v. Milwaukee**, 272 U. S. 713 (1927), an "exclusion from the measure of the tax of all income except from Federal bonds"; and unlike that case there was no attempt by Pennsylvania "to measure the tax by exempt income while excluding from the measure all taxable income".

Rather like California, in Pacific Co. v. Johnson, supra, and like Oklahoma, in Tradesmen's National Bank case, supra, Pennsylvania in its legislation "has indulged in no reversal of policy so far as the measurement of the franchise tax is concerned, and in no discrimination

either in favor of or against tax-exempt income."

Thus, a State tax statute is "discriminatory and hostile" within the meaning of the United States Supreme Court decision, when its passage evidences a change or reversal of legislative policy directed toward placing the burden upon theretofore exempt property or income:

> See Miller v. Milwaukee, supra;
>
> **Macallen Co. v. Massachusetts,** 279 U. S. 620 (1929).

On the other hand, a tax statute is neither "discriminatory" nor "hostile" merely because the unintended consequence of the legislative act directed toward taxable subject matter may place a casual or incidental burden on tax exempt property or income: Flint v. Stone Tracy Co., supra; Educational Films Corp. v. Ward, supra; Tradesmen's National Bank of Oklahoma City v. Oklahoma Tax Commission, supra; Pacific Co. v. Johnson, supra.

Section 4 of the Public Debt Act of February 19, 1941 (c. 7, Sec. 4, 55 Stat. 9) provides as follows:

> "Sec. 4. (a) Interest upon, and gain from the sale or other disposition of, obligations issued on or after the effective date

of this Act by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations shall not have any special treatment, as such, under Federal Tax Acts now or hereafter enacted; * * *".

The passage of this Act is further evidence of the attitude of Congress that the withholding at least of Federal tax immunity from interest on United States obligations will not impair its borrowing power; and thus supports the view underlying its previous approval of the inclusion of such interest in the measure of a State excise tax imposed for the privilege of doing business within the State. In neither case, Congress feels, is the borrowing power of the Federal Government impaired.

With respect to the charge of hostile discrimination in favor of interest from State or municipal obligations, the taxpayer's complaint is grounded on the Legislature's **omission to include** such income in the measure of tax, immediately following the passage by Congress of the Public Debt Act of 1941. While it may be claimed that a reversal or change in legislative policy through subsequent enactments results in discrimination (See Pacific Co. v. Johnson, supra), here it is claimed, in effect, that a re-

versal or change in legislative policy was effectuated through omission to enact.

Commonwealth v. Schuylkill Trust Co., 38 Dauph. 22, 315 Pa. 429, 296 U. S. 113, involved a tax on the shares of stockholders in a trust company under the Act of June 13, 1907, P. L. 640, as amended by the Act of July 11, 1923, P. L. 1071, by the Act of May 7, 1927, P. L. 853, and the Act of April 25, 1929, P. L. 675.

The case came before the Supreme Court of the United States on two occasions—296 U. S. 113 (1935), and 302 U. S. 506 (1938). Mr. Justice Roberts wrote the majority opinion (three justices dissenting) in the first case, and the opinion of the Court without dissents in the second case.

In the earlier case, Mr. Justice Roberts, without determining the nature of the tax, had stated at page 119, citing cases:

> "**If** the tax is one truly upon that independent property evidenced by the ownership of a share of corporate stock its collection does not discriminate against United States securities." (Boldface ours)

In the latter case, Mr. Justice Roberts, finally determining the nature of the tax, stated at page 513:

"* * * We are of opinion that the tax is one upon the shares as such and not upon the assets of the company.

"Fourth. The State need not have made any exemption or concession in taxing the property in the shares on account of value therein reflected from the company's ownership of obligations of the government or its instrumentalities other than national bank stock. (Citing same cases)."

Nevertheless, in the earlier case, a majority of this Court held that the shares tax as settled against the taxpayer discriminated against Federal obligations. The source of this "discrimination" was attributed to the legislative action of the State in excluding in the computation of net assets the value of shares in Pennsylvania corporations which were already taxed or relieved from tax by State law, while providing for no corresponding deduction on account of Federal securities.

The legislative action by the State referred to was embodied in two amendments to the original Act of 1907, supra. The amendment of 1923, supra, excluded shares of stock of Pennsylvania corporations **already taxed**; the amendment of 1927, supra, went further and excluded shares of stock of Pennsylvania corporations **relieved** from tax.

Obviously, in the absence of these amendments, and under the original Act of 1907, there would have been no exemptions, and hence no discrimination. The two statements of Mr. Justice Roberts, in each of the separate opinions, would be easily reconcilable and conclusive of the issue.

While a majority of this Court found discrimination by reason of the effect of the exemption amendments, the dissenters found no "unfriendly discrimination" because the purpose of exemptions was "to avoid double taxation or something akin thereto".

Despite this difference of opinion between majority and minority as to whether the effect of the exemption amendments was discriminatory, both recognized the basic fact that there had been some affirmative legislative action by Pennsylvania changing the policy with respect to calculation of the taxable value of shares in trust companies.

In summarizing the distinction between the Schuylkill case and the instant case, it may be pointed out (1) the Schuylkill case involved a **property tax** on shares in hands of shareholders of trust companies; the instant case involves an excise tax for a corporation's privilege of doing business in the Commonwealth; (2) the Schuyl-

kill case involved affirmative legislative action granting exemptions which reflected a change in policy and resulting in what a majority of a divided Court termed "discrimination"; in the instant case, there was no change in Pennsylvania legislation reflecting a reversal of policy, the only legislative change being on the part of the Federal Government which enacted the Public Debt Act of 1941.

Finally, it may be pointed out that the line of cases more appropriately relevant than the Schuylkill case to the issue in the instant case, are decisions that both preceded and followed that case. The authorities referred to and discussed earlier in this brief are: Home Ins. Co. v. New York, supra, (1890); Flint v. Stone Tracy Co., supra, (1911); Educational Films Corp. v. Ward, supra, (1931); Pacific Co. v. Johnson, supra, (1932); Tradesmen's National Bank v. Oklahoma Tax Comm., supra, (1940).

4. Summary

The position of the Commonwealth of Pennsylvania, petitioner, in the instant case may be summarized as follows:

1. The Pennsylvania Corporate Net Income Tax Act of May 29, 1941, P. L. 62, is

not a property tax; it is not a tax on the privilege of investing in United States obligations; nor is it a tax on the privilege of doing business measured exclusively by income from investments in United States obligations. It is, as construed by the court of last resort in Pennsylvania, **an excise tax on the privilege of doing business in the Commonwealth measured by the net income as returned to and ascertained by the Federal Government.**

Accordingly, the Pennsylvania Act only takes the net income fixed by the Federal Government as the base for the excise privilege tax levied by the Commonwealth, and it is of no concern to the taxing officers of the Commonwealth, nor to its statute, how the net income was fixed by the Federal authorities. Hence, no variance or modification of the Pennsylvania tax base is permitted to the taxing officers of the Commonwealth in computing corporate net income tax liability beyond such adjustment as may be authorized by express statutory language providing therefor.

2. Generally, no corporate franchise or privilege tax measured by a base which includes in part interest on United States obligations violates thereby either Article VI,

Clause 2, and/or Article I, Section 8, Clause 2, of the United States Constitution. In like manner, the Pennsylvania corporate net income tax is not in violation of these provisions, the reflection of the income derived from United States obligations issued after March 1, 1941, in the measurement of the tax not being a tax on that income, but being merely incidental to the operation of the formula which determines the value of the privilege of doing business in this Commonwealth.

3. The Pennsylvania corporate net income tax, measured by "net income as returned to and ascertained by the Federal Government", is neither discriminatory, hostile nor burdensome. In so far as income from State and municipal obligations is concerned, there is nothing on the face of the Act that supports a charge of discrimination. There is no evidence whatsoever to establish actual discrimination, or discrimination in fact, in favor of income from State and municipal obligations and against income from United States obligations.

There has been no Pennsylvania legislation enacting a reversal of policy so far as the measurement of the tax is concerned so

as to discriminate either in favor of, or against, tax-exempt income. The measurement of the tax, in so far as income from Federal, State or municipal obligations is concerned, has in fact remained unaltered by any Pennsylvania legislation.

Accordingly, it is respectfully submitted that the record in this case presents an important Federal question of substance which has been decided by the Supreme Court of Pennsylvania in a way probably not in accord with the decisions of this Court, and that the petition for review on writ of certiorari be granted.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 617

COMMONWEALTH OF PENNSYLVANIA,
Petitioner,

vs.

THE CURTIS PUBLISHING COMPANY,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

I.

OPINIONS OF THE COURTS BELOW

(1) The opinion of the Court of Common Pleas of Dauphin County, Pennsylvania (R. 111a) is reported in 59 Dauphin County Reporter 430. This opinion was handed down October 10, 1947.

(2) The opinion of the Supreme Court of Pennsylvania (R. 165) is reported in 363 Pa. 299; 69 A. 2nd 410. This opinion was handed down on November 22, 1949.

II.

JURISDICTION

The Judgment of the Supreme Court of Pennsylvania was entered November 22, 1949.

The Petitioner invokes the jurisdiction of this Court under Section 1257(3) of the Judicial Code, 62 Stat. 929, 28 U. S. C. 1257(3).

III.

COUNTER STATEMENT OF THE CASE

Respondent, The Curtis Publishing Company of Pennsylvania, is a Pennsylvania corporation. During the year 1942 it was engaged in business in the Commonwealth of Pennsylvania and was subject to the tax imposed by the Pennsylvania Corporate Net Income Tax Act of 1935, P. L. 205, as re-enacted and amended by the Act of 1941, P. L. 62.* (R. 111a) The base on which the amount of this tax is computed is the net income as returned to and ascertained by the Federal Government, subject to any correction thereof as finally ascertained by the Federal Government.

In compliance with this Act Respondent filed its report for the calendar year 1942 with the Petitioner, the Commonwealth of Pennsylvania (hereinafter referred to as the "Commonwealth"), and subsequently Respondent filed a "Report of Change" in its net income, as required by the statute. (R. 112a)

Included in its changed net income was $75,389.62 interest on United States securities issued subsequent to March 1, 1941, which interest was subject to *Federal* income tax and was included in the net income returned to and ascertained by the Federal Government under the provisions of the Federal Public Debt Act of February 19, 1941, chapter 7, section 4, 55 Stat. 9. (R. 47a, 48a, 116a, 157a)

In the settlement of tax based upon this changed net income not only was $75,389.62 interest on United States securities *included* in the tax base, but there was *excluded* therefrom $19,256.25 interest on securities issued by municipalities of the Commonwealth and $48,704.09 interest on securities issued by the Commonwealth itself. (R. 48a-50a,

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*No "Purdon's Pennsylvania Statutes" citation for this Act can be given because it was amended subsequent to 1941 and does not now appear in Purdon's in its 1941 form.

115a, 158a) There was also *excluded* from such tax base dividends in the amount of $758,565.68 received by the Respondent on corporate shares owned by it. (R. 48a, 117a)

The Pennsylvania corporate net income tax was first imposed by the Act of 1935, P. L. 208, for the years 1935 and 1936. The tax was continued for later years by subsequent re-enactments, none of which, however, made any changes affecting the matter here involved.

The initial taxing practice adopted by the fiscal officers of the Commonwealth when the Act was first enacted was to compute the tax upon a base which *included* interest on United States securities. This inclusion was challenged in the Pennsylvania courts and on May 8, 1939, in the Court of Common Pleas of Dauphin County, Pennsylvania, in the case of *Commonwealth* v. *Philadelphia Felt Company* (No. 624 Commonwealth Docket 1938) the Commonwealth entered a judgment by stipulation in which it agreed that the tax should be computed upon a base which *excluded* interest on United States securities. (R. 52a, 113a)

Thereafter, on June 28, 1939, the Department of Revenue of the Commonwealth issued a ruling instructing all its taxing officers that "interest received from United States securities is exempt for corporate net income tax purposes." Pursuant to this ruling an exemption of interest on United States securities was granted, for the years 1935, 1936 and 1937, to all taxpayers which had made claim for such exemption, and it was allowed for the years 1938, 1939 and 1940 to all taxpayers who had received any interest on United States securities during those years. (R. 53a, 113a, 114a)

However, in 1941 the Commonwealth abandoned this practice and for the year 1941 and thereafter the Commonwealth computed the tax upon a base which *included* interest on all United States securities which were issued on or after March 1, 1941. The inclusion of this interest on United States securities in the tax base increased the Re-

spondent's 1942 corporate net income tax by the amount of $3,818.66 (R. 139a), which additional tax would not have been imposed had an equivalent amount of interest on State and municipal securities been received in lieu of the aforesaid interest on United States securities.

Respondent contends, and the Commonwealth denies, that the corporate net income tax settled against the Respondent for the year 1942, which was thus computed upon a tax base which *included* interest on United States securities and *excluded* interest on securities issued by the Commonwealth and its municipalities and dividends on corporate shares owned by Respondent, discriminated against United States securities in violation of Article VI, clause 2, and Article I, Section 8, clause 2, of the Constitution of the United States.

Both the Court of Common Pleas of Dauphin County, Pennsylvania (R. 111a-140a) and the Supreme Court of the Commonwealth of Pennsylvania (R. 165-186) sustained the Respondent's contention.

IV.

COUNTER STATEMENT OF THE QUESTION PRESENTED

The fiscal officers of the Commonwealth settled the Pennsylvania corporate net income tax account of the Respondent for the year 1942 upon a tax base which *included* interest on United States securities issued after March 1, 1941, but which *excluded* interest received by the Respondent from securities issued by the Commonwealth and certain of its municipalities and dividends on corporate shares owned by the Respondent.

Did such settlement discriminate against United States securities in violation of Article VI, clause 2, and/or Article I, Section 8, clause 2, of the Constitution of the United States?

V.

ARGUMENT

A. The Pennsylvania Corporate Net Income Tax Act as Applied to the Respondent for the Year 1942, Discriminates Against United States Securities in Favor of State and Municipal Securities and Corporate Shares.

As pointed out hereinbefore in the Respondent's Counter Statement of the Case, the Pennsylvania Corporate Net Income Tax Act of 1935, P. L. 208, as re-enacted and amended by the Act of 1941, P. L. 62, imposed a tax measured by net income as returned to and ascertained by the Federal Government, subject to certain specific deductions.

The nature of the tax base thus provided for led the Department of Revenue of the Commonwealth to prescribe, verbatim, as Page 1 of the 1935 Pennsylvania corporate net income tax report form, that portion of the Federal corporation income tax return form used to arrive at the "net income" of the taxpayer.* This net income, which was accordingly the same figure in both the Pennsylvania form and the Federal form in any particular case, was used as the base for computing the Pennsylvania tax. (R. 88a, Stip. of Facts, Ex. C; 113a)

The Corporate Net Income Tax Act in defining the taxable net income made no specific reference to the treatment to be afforded interest on bonds of the Commonwealth of Pennsylvania and its various municipalities, or the treatment to be afforded interest on United States securities. However, it contained a specific provision in Sec. 2(1) that dividends on corporate shares owned by the taxpayer should be deducted from the net income used as the tax base.

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* Section 4 of the Pennsylvania Corporate Net Income Tax Act imposed upon the Department of Revenue of the Commonwealth the duty to prescribe the form of report to be made.

Inasmuch as interest on *State and municipal securities* is wholly exempt from Federal income tax under the Internal Revenue Code (Sec. 22(b)(4)), and is not included in *gross* income as reported on the Federal income tax return form, the interest on such securities is entirely eliminated from the net income as returned to and ascertained by the Federal Government which is used as the base for the Pennsylvania tax.

Although interest on certain *United States securities* which is wholly exempt by Acts of Congress from all Federal income tax liability is specifically excluded from the Federal net income by Sec. 22(b)(4) of the Internal Revenue Code, *all other interest on United States securities* is included in this Federal net income.

Thus, proceeding under a strict application of the Corporate Net Income Tax Act, the Commonwealth attempted to impose the tax upon a base which *included* interest on certain United States securities, but which *excluded* interest on all State and municipal securities and dividends on corporate shares. (R. 113a)

Certain taxpayers objected to this inclusion of interest on United States securities in the Pennsylvania tax base for the year 1935, and the Commonwealth recognized that such treatment of interest was invalid *(Com. v. Philadelphia Felt Company, No. 624 Com'th Docket, 1938,* Court of Common Pleas of Dauphin County). (R. 52a-54a, 113a) Accordingly, for the years 1935 to 1940, inclusive, interest on United States securities was *excluded* from the tax base. (R. 54a) This *exclusion* was effected for the years 1935 to 1937, inclusive, by making a separate deduction of such interest when the tax was resettled, with respect to those taxpayers which had claimed that interest on United States securities should be deducted. This *exclusion* was effected for the year 1938 in the original settlement of all accounts by making a separate deduction of the interest on United States securities. (R. 53a, 113a, 114a)

For the years 1939 and 1940 the Pennsylvania corporate net income tax form effected the exclusion of interest on United States securities by the simple expedient of adding to the portion thereof copied from the Federal return form the two lines used in that form to arrive at "adjusted net income" from "net income." (R. 54a, 114a, Stip. of Facts 88a, Ex. G, page 2, line 32, Ex. H, page 2, line 34) During those years the Federal "net income" was the amount upon which the Federal *surtax* was computed and included certain interest on United States securities, while "adjusted net income" was the amount upon which the Federal *normal tax* was computed and excluded all interest on United States securities. (Internal Revenue Code (1938) Secs. 13(a), 25 and 26).

This incorporation in the Pennsylvania corporate net income tax report forms for the years 1939 and 1940, of the portion of the Federal return form used to arrive at "adjusted net income," and the practice followed by the Commonwealth of computing the Pennsylvania tax liability on the basis of this "adjusted net income" figure, constituted an *effective and self-executing method of eliminating all interest on United States securities from the Pennsylvania tax base* for those two years.

However, beginning with the year 1941 the Commonwealth could no longer solve its problem of eliminating interest on United States securities from the tax base by resorting to the Federal "adjusted net income" as a base from which all interest on United States securities had been eliminated. In that year Congress adopted the Public Debt Act of 1941, which became effective March 1, 1941 (Feb. 19, 1941, C. 7, Sec. 4, 55 Stat. 9).* This Act provided, in part, as follows:

> "Sec. 4. (a) Interest upon, and gain from the sale or other disposition of, *obligations issued on or after*

* No "United States Code" citation for this Act can be given because it was amended subsequent to 1941 and does not now appear in the Code in its 1941 form.

> *the effective date of this Act by the United States, or any agency or instrumentality thereof shall not have any exemption, as such,* and loss from the sale or other disposition of such obligations shall not have any special treatment, as such, under *Federal* tax Acts now or hereafter enacted; . . ." (Italics added)

By virtue of this Act, the interest on United States securities issued on or after March 1, 1941, became wholly subject to *Federal* income tax liability—both normal tax and surtax. As a consequence, *interest on United States securities issued on or after March 1, 1941* was no longer excluded in arriving at the Federal "adjusted net income."

Thus, for the tax year 1941 and thereafter, interest on United States securities issued prior to March 1, 1941, was excluded from "net income" in arriving at "adjusted net income" under the Federal return, while interest on United States securities issued on or after March 1, 1941, was allowed to remain in "adjusted net income" and was subjected to the "normal tax" on corporation income. (R. 114a, 115a)

As a result of this radical change in the method of computing the Federal income tax, the resort by the Commonwealth to the Federal "adjusted net income" as the Pennsylvania tax base could no longer operate as a means of excluding all interest on United States securities from such base, if the taxpayer involved owned any United States securities issued on or after March 1, 1941. (R. 114a)

Nevertheless, the Commonwealth arbitrarily continued to use "adjusted net income" as the tax base for the year 1941 and thereafter, *thus including in the taxable income all interest on United States securities issued on or after March 1, 1941.* (R. Stip. of Facts 88a, Ex. I, page 2, line 34; Ex. J, page 2, line 37.)

In view of the circumstances involved, this course of conduct by the Commonwealth must have been designed solely to include interest on United States securities, issued on or after March 1, 1941, in the Pennsylvania corporate

net income tax base. The fact that this course of conduct consisted of inaction on the part of the Commonwealth changes neither the motive behind it nor its practical effect.

The results of the Commonwealth's refusal to depart from "adjusted net income" as the tax base for the year 1941 and thereafter, operated upon the Respondent's 1942 corporate net income tax base in the manner set forth in the following table:

Type of Income Received	*Amount Received*	*Amount Excluded from Tax Base*	*Amount Included in Tax Base*
Interest on Municipal securities	$19,256.25	$19,256.25	.....
Interest on Commonwealth of Pa. securities	48,704.09	48,704.09	.....
Interest on Panama securities	1,531.56	1,531.56	.....
Totals	$69,491.90	$69,491.90	..... (R. 115a, 158a)
Interest on United States securities ...	76,251.05	861.43	$75,389.62 (R. 116a, 157a)
Dividends on Corporate Shares	$758,565.68	$758,565.68	..... (R. 117a, 156a)

The item of $75,389.62 of interest on United States securities included in the tax base, indicated above, represents interest received by the Respondent in 1942 on United States securities all of which were issued on or after March 1, 1941. (R. 116a) Pursuant to the provisions of Section 4 of the Public Debt Act of 1941, referred to earlier in this brief, this interest was wholly subject to *Federal* income tax liability and was included in the "adjusted net

income" upon which the Respondent's Pennsylvania tax was based. (R. 154a, page 2, line 9(b))

The Supreme Court of Pennsylvania concluded that this treatment afforded interest on United States securities received by the Respondent in 1942 was discriminatory and was in violation of Article VI, clause 2, and Article I, Section 8, clause 2, of the Constitution of the United States. In arriving at this conclusion the Court expressly rejected the Commonwealth's argument that the *Federal* Government was responsible for the discrimination by reason of its change in policy with respect to the liability of interest on United States securities for *Federal* income tax. The Pennsylvania Supreme Court ruled in the most positive language, that any discriminatory treatment of United States securities arising under this legislation was the sole responsibility of the Commonwealth of Pennsylvania.

In this connection the Court made the following statements: (R. 171-172)

> "Pennsylvania in imposing its excise tax on the net income of the Curtis Publishing Company permitted deductions of the interest received on securities of the state and its subdivisions and provided for adjustment of the tax base by way of deductions therefrom of dividends on corporate shares but did not permit deductions of the interest paid on United States obligations. This anomaly arises from the fact that the Pennsylvania Taxing Act takes the corporation's annual return as made to and ascertained by, the Federal government as the basis of the annual tax it imposes on corporations doing business in Pennsylvania. But this *bookkeeping* fact does not affect the *political* fact that the command to tax the net income emanates from the sovereignty of Pennsylvania and not from the sovereignty of the United States. By adopting this mode of *ascertaining* the tax to be imposed Pennsylvania did *not* delegate to the Federal government any of the State's power to tax. *The act of taxing is the act of the Commonwealth of Pennsylvania.* See Common-

wealth v. Warner Bros. Theatres, Inc., 1942, 346, Pa. 270, 27 A. 2d 62.

* * * * * * *

(R. 184)

"... Nor is there any merit in the contention that this discrimination was *not intended* by Pennsylvania but resulted from the passage of the Public Debt Act. The constitutionality of any statute cannot be determined by a consideration of the motives behind its enactment. As the Supreme Court of the United States has repeatedly pointed out, while a taxing act's character in respect to its being discriminatory against federal securities may be determined by its expressed or implied intention, *it may also be determined by its operation and effect.* Taxing acts (like human acts) usually take their character from their consequences."

The Pennsylvania Supreme Court also found occasion in this decision to emphasize the direct and prejudical effect upon the marketability of United States securities resulting from this discriminatory treatment. This effect was described as follows by the Court:

(R. 183-184)

"The overpayment of the 1942 Corporate Net Income Tax by the Curtis Publishing Company was found by the Court below to be $3,818.66. This meant that a portion of the company's taxed income amounting to $54,552 (after the required statutory allocation) was income derived from federal securities. Since there are approximately 38,000 corporations paying the Pennsylvania Corporate Net Income Tax and since a large proportion of these corporations presumably derive a portion of their income from their holdings of United States securities, it can be readily seen that for Pennsylvania to tax these securities while it does not tax *its own,* will to a very substantial degree impair the marketability of national securities in Pennsylvania. A discrimination effecting such a result cannot be dismissed as merely 'casual or incidental' (as the

appellant asserts). The United States Supreme Court has never hesitated to strike down such state discrimination against national securities. . . . . "

* * * * * * * *

(R. 184-185)

". . . When Pennsylvania *exempts* from taxation its own securities but *taxes,* directly or indirectly, the securities of the *United States* the latter securities are handicapped in their competition with the securities of Pennsylvania, among buyers in the market place. This handicapping is by implication proscribed by the Constitution of the United States.

"The Corporation which finds its Pennsylvania annual tax bill increased by $3,500 because among its assets there is an income of $50,000 from *federal* securities, ('allocated' to Pennsylvania) while its competitor which has a $50,000 income from *Pennsylvania* securities is taxed nothing on *those* securities will find no comfort in the assurance that the discrimination against it is merely 'casual and incidental.' A tax burden is never lightened by the label attached to it or by the fact that the burden took a roundabout way to reach the taxpayer's back. If the discrimination above described is legally permissible no corporation taxpayer when purchasing government securities, will be as much inclined to buy securities of the national government as he will be to buy the tax-exempt securities of Pennsylvania."

The Respondent accordingly submits that there is no room for any doubt as to the discriminatory effect of the Pennsylvania corporate net income tax upon United States securities under the circumstances here involved. This effect constitutes a substantial impairment of the marketability of such securities and is the direct and calculated result of the construction and application of the statute by the fiscal officers of the Commonwealth.

It will be demonstrated in the remaining portion of this brief that such an application of the Pennsylvania legisla-

tion was properly ruled to be unconstitutional under the authority of an unbroken line of decisions of this Court.

B. A State tax which discriminates against United States securities is unconstitutional under an unbroken line of decisions of this Court.

It is respectfully submitted that this case is not a proper one for review by certiorari in this Court, and that the Commonwealth's petition should be denied, for the reason that the issue of discrimination against United States securities which is here involved is no different, except for the circumstances under which it arose, from similar issues which have been decided in numerous decisions of this Court. This was clearly recognized by the Pennsylvania Supreme Court when it said (R. 176):

> ". . . . No case has been brought to our attention, and we have found none, in which the United States Supreme Court has upheld *any* tax imposed by a state if that tax discriminated either directly or indirectly against the securities of the United States. There is no decision of the United States Supreme Court which weakens in the slightest degree the mandate of that court as expressed in many cases that states cannot in their tax acts discriminate against the securities of the United States in favor of their own securities. The United States Supreme Court has been consistent and adamant in its rulings that there must be equality of treatment by the state imposing taxes, either direct or indirect, on the respective securities of the state and nation."

The Petitioner on page 14 of its petition avers that "the Supreme Court of Pennsylvania has decided a Federal question of substance and importance which has not heretofore been determined by this Court and in a manner probably not in accord with the applicable decisions of this

Court." As will appear from the authorities hereinafter referred to, this averment is erroneous.

* * * * * * *

In the leading case of *M'Culloch* v. *Maryland,* 4 Wheat. 316 (1819), this Court recognized that the Federal Government, its agencies and instrumentalities must be kept free from any burdensome or discriminatory State taxation. This conclusion was deemed to be a necessary implication from the provisions of Article VI, clause 2, of the Federal Constitution, which established that Constitution and the laws made in pursuance thereof as the Supreme Law of the land.

During the years following that decision the basic principle established therein was applied to numerous situations involving State taxes which affected the Federal Government or its agencies and instrumentalities. However, the present case involves only that phase of the Federal Government's immunity from State taxation which concerns taxation affecting United States securities or the interest thereon.

In this connection the general principle based upon Article VI, clause 2, first expressed in *M'Culloch* v. *Maryland,* must be considered in conjunction with Article I, Section 8, clause 2, which authorizes Congress to borrow money on the credit of the United States.

As a result of the necessary implication derived from these two constitutional provisions, it has been deemed axiomatic that a State tax imposed *directly upon* United States securities or the interest therefrom is invalid. Such a tax is an interference with the sovereignty of the Federal Government and imperils its borrowing power.

Weston v. *City Council of Charleston,* 2 Pet. 449 (1829);
New York ex rel. Bank of Commerce v. *Comrs. of Taxes and Assessments,* 2 Black 620 (1862);
Hamilton Mfg. Co. v. *Mass.,* 6 Wall. 632 (1867);
Bank Tax Case, 2 Wall. 200 (1865);

Bank v. *Supervisors,* 7 Wall. 26 (1869);
Home Savings Bank v. *Des Moines,* 205 U. S. 503 (1907);
Farmers & Mechanics Savings Bank v. *Minnesota,* 232 U. S. 516 (1914);
Northwestern Mutual Life Insurance Company v. *Wisconsin,* 275 U. S. 136 (1927);
Macallen Co. v. *Massachusetts,* 279 U. S. 620 (1929).
New Jersey Realty Title Insurance Co. v. *New Jersey,* 338 U. S. 665 (1950).

The Commonwealth in the present case attempts to support the constitutionality of the Pennsylvania corporate net income tax by pointing out that this tax has been determined by the Pennsylvania Supreme Court in a number of cases to be an excise tax, and that, where a State excise tax is involved, it is proper to include United States securities or the interest therefrom in the measure of the tax. There can be no doubt that there are various types of State taxes, including excise taxes, which affect United States securities in such an indirect manner that the Federal immunity is not violated.

This has been recognized in numerous decisions of this Court. A State inheritance tax is valid, although measured by the value of United States bonds which are transmitted: *Plummer* v. *Coler,* 178 U. S. 115 (1900); *Orr* v. *Gilman,* 183 U. S. 278 (1902). Similarly, a State tax on the shares of National Banks, in the hands of the stockholders, is valid although the banks own tax exempt United States Bonds: *Van Allen* v. *Assessors,* 3 Wall. 573 (1865); *People* v. *Commissioners,* 4 Wall. 244 (1866); *Des Moines National Bank* v. *Fairweather,* 263 U. S. 103 (1923). A similar State tax upon the shares of State banks has likewise been sustained: *Home Ins. Co.* v. *New York,* 134 U. S. 594 (1890); *Schuylkill Trust Co.* v. *Penna.,* 302 U. S. 506 (1938) and 296 U. S. 113 (1935); *Home Savings Bank* v. *Des Moines,* 205 U. S. 503 (1907).

In the realm of corporate franchise or privilege taxes imposed by a State, it is well established that such taxes

may be measured by net assets, even though such assets may include United States securities: *Tradesmens National Bank* v. *Oklahoma Tax Comm.*, 309 U. S. 560 (1940); *Home Ins. Co.* v. *New York*, 134 U. S. 594 (1890); *Provident Inst. for Sav.* v. *Massachusetts*, 6 Wall. 611 (1867); *Society for Savings* v. *Coite*, 6 Wall. 594 (1867). With respect to corporate franchise or privilege taxes imposed by a State and measured by net income, a similar rule is applied. It has been held that such a State tax is valid regardless of the fact that the net income used as the base of the tax includes interest on United States securities: *Tradesmens Natl. Bank* v. *Oklahoma Tax Commission*, 309 U. S. 560 (1940).

However, the mere fact that the Pennsylvania corporate net income tax has been held by the Pennsylvania Supreme Court to be an excise tax by no means makes the foregoing precedents applicable in the instant case so as to validate the inclusion of interest on United States securities in the tax base. There is an additional and inflexible requirement which must be met, even in the case of those types of State taxes which are, under certain circumstances, permitted to affect United States securities because their incidence upon such securities is sufficiently indirect. This requirement is that *no State tax, regardless of its nature, may discriminate against United States securities.*

This Court has uniformly recognized this principle and has indicated that the prohibited discrimination may result either from affording other securities, or the return thereon, a more favorable treatment in the assessment of the tax, *Schuylkill Trust Company* v. *The Commonwealth of Pennsylvania*, 296 U. S. 113 (1935); or from imposing some additional burden upon the taxpayer merely because it owns United States securities, *Missouri Ins. Co.* v. *Gehner*, 281 U. S. 313 (1930).

The absolute necessity for a lack of discrimination in the operation of any State tax affecting the Federal Government was clearly recognized by this Court as early as

its decision in *M'Culloch* v. *Maryland, (supra)* (1819). In the opinion in that case this Court said: (4 Wheat. p. 436)

> "This opinion does not deprive the States of any resources which they originally possessed. It does not extend to a tax paid on the real property of the bank, in common with the other real property within the State, *nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the State.*" (Italics added)

The factor of discrimination, which was involved in *M'Culloch* v. *Maryland, supra,* was commented upon in *Helvering, Commissioner* v. *Gerhardt,* 304 U. S. 405 (1938), which involved the authority of the Federal Government to impose income tax upon the compensation of an employee of the Joint Port Authority of the States of New York and New Jersey. The Court sustained the validity of the tax but, in the opinion written by Mr. Justice Stone, the following statement appears (p. 413):

> "It was perhaps enough to have supported the conclusion [in *M'Culloch* v. *Maryland*] that the tax was invalid, *that it was aimed specifically at national banks and thus operated to discriminate* against the exercise by the Congress of a national power. Such discrimination was later recognized to be *in itself* a sufficient ground for holding invalid any form of state taxation adversely affecting the use or enjoyment of federal instrumentalities. *Miller* v. *Milwaukee,* 272 U. S. 713; cf. *The Pacific Co., Ltd.* v. *Johnson,* 285 U. S. 480, 493." (Italics added)

The prohibition of any type of discrimination against the Federal Government or its agencies and instrumentalities has been reiterated in numerous subsequent decisions of this Court and, in fact, it has never, since the immunity of the Federal Government from State taxes was first established, so much as intimated that a State tax, regardless of its nature, could be sustained if it discriminates against the Federal Government or its agencies or instrumentali-

ties. On the contrary, the Court has clearly indicated that valid State taxes must be non-discriminatory.

In *Educational Films Corporation of America* v. *Ward*, 282 U. S. 379 (1930), the Court said: (p. 392)

> "Having in mind the end sought, we cannot say that the rule applied by this Court for some seventy years, that a *non-discriminatory* tax upon corporate franchises is valid, notwithstanding the inclusion of tax exempt property or income in the measure of it, has failed of its purpose, or has worked so badly as to require a departure from it now; or that the present tax, viewed in the light of actualities, imposes any such real or direct burden on the federal government as to call for the application of a different rule." (Italics added)

And in *Willcuts* v. *Bunn*, 282 U. S. 216 (1931), the Court said: (p. 227)

> "But it does not follow, because a tax on the interest payable on state and municipal bonds is a tax on the bonds and therefore forbidden, that the Congress cannot impose a *non-discriminatory* excise tax upon the profits derived from the sale of such bonds. . . ." (Italics added)

The decision of this Court which is most nearly in point with respect to the present case is the comparatively recent case of *Schuylkill Trust Company* v. *The Commonwealth of Pennsylvania*, 296 U. S. 113 (1935), which involved the Pennsylvania tax on the shares of trust companies imposed under the Act of 1907, P. L. 645, as last amended by the Act of 1929, P. L. 673. Under this legislation, the value of the shares subjected to the tax was ascertained by adding together so much of the capital stock paid in, the surplus and undivided profits as was not invested in shares of stock of corporations liable to pay, or relieved from, a capital stock tax or tax on shares. In practice, the method of determining the value of the shares was to add together the capital, surplus and undivided prof-

its and deduct, either fully or proportionately, the value of shares of corporations liable to or relieved from the capital stock tax, or tax on shares.

During the year 1930, the Schuylkill Trust Company owned United States securities, and securities of Federal agencies and dependencies, of a value of $151,207 and, in addition thereto, shares of stock of a national bank with a value of $20,202. It also owned shares of stock of other corporations liable to, or relieved from the payment of, a capital stock tax or tax on shares.

In ascertaining the value of the shares of the company subject to the shares tax, the taxing officers of the Commonwealth added together the capital, surplus and undivided profits and deducted therefrom a proportion of the value of the shares of the other corporations liable to or relieved from taxation, including the shares of stock of the national bank. *No deduction whatever was made on account of the United States securities.*

The Court of Common Pleas of Dauphin County, Pennsylvania, in a decision reported in 38 Dauphin 22 (1934), rejected the company's contention that a deduction should have been afforded United States securities, holding that, as the tax was a tax upon shares and not upon the assets of the trust company, those securities had not, in fact, been taxed. This ruling was affirmed by the Supreme Court of Pennsylvania in a decision reported in 315 Pa. 429 (1934). However, when an appeal was taken from this decision, this Court, in an opinion written by Mr. Justice Roberts, declared that the failure to afford the same deduction to United States securities as was given shares of corporate stock resulted in unconstitutional discrimination against such United States securities. In this opinion, the following discussion appears (296 U. S. p. 120):

> "We think that the issue of discrimination is not to be resolved by a choice between the two contentions as to the nature of the tax. The point is that the State

has chosen a portion only of the net assets of the corporation as a measure of the tax, whether the exaction be from the company or its shareholders. The State has exempted certain assets on the theory that to measure the tax in part by their value would in effect be to tax them twice. If to measure the shareholder's tax by inclusion of these taxed or exempted securities found amongst the company's assets would be to tax the shareholder in virtue of the company's ownership of those securities, it seems clear that to refuse to exempt United States securities from the measure of the tax is to lay a tax reckoned upon their value. To put it otherwise, if to exclude securities already taxed or exempted from tax pursuant to the policy of the Commonwealth avoids double taxation, to include United States securities in the measure of the tax seems inevitably to increase the burden of the tax by reason of their ownership. If the burden of the tax be lifted in respect of some securities (as it is by confession from those issued by certain Pennsylvania corporations) it must necessarily fall on the remaining securities owned by the company. *If the tax is lifted from the shares of certain trust companies because those companies own only stocks already taxed or relieved from taxation by the State, and shares in other trust companies are taxed amongst whose assets there are United States bonds or other securities entitled to exemption because issued by federal instrumentalities, which are figured in the base of the tax, it is impossible to avoid the conclusion that the law discriminates in favor of the former and against the latter solely by reason of ownership of such federal securities.*" (Italics added.)

Certainly if, in the imposition of a *shares tax* (which would ordinarily be sustained as having only an indirect or remote effect upon any United States securities owned by the corporation involved) the failure to afford the same exemption to *United States securities* as is afforded *shares of corporate stock* results in unconstitutional discrimination against such United States securities, it necessarily follows that, in the imposition of a corporate net income

tax, the failure to afford the same exemption to *interest on United States securities* as is afforded *dividends on corporate stock* likewise results in unconstitutional discrimination. The additional factor present in this case, that in the imposition of the corporate net income tax an exemption is allowed for *interest on State and municipal securities,* constitutes even more conclusive evidence of illegal discrimination, for United States securities are in more constant and substantial competition with State and municipal securities in the investment field than they are with corporate shares.

Moreover, the weight of the Schuylkill Trust Company decision as a controlling precedent in the instant case is increased by the fact that the tax involved in the Schuylkill case was upon the shareholders of the trust company and not upon the *owner* of the United States securities (the Trust Company) and thus the incidence of the tax with respect to such securities was necessarily less direct than in the present case in which the tax involved is a tax imposed upon the *owner* of the United States securities.

It is of interest to note that, even in Mr. Justice Cardozo's dissenting opinion in this Schuylkill Trust Company case, in which he held that the tax on the shares of trust company's stock there involved did not discriminate against United States securities, he clearly indicated that, under such facts as exist in the instant case, the tax could not be sustained. In other words, the very illustration of a discriminatory and unconstitutional tax which he described in his dissenting opinion, exists in the instant case. In the present case no tax is imposed with respect to the interest on State and municipal securities, whereas interest on United States securities is included in the tax base. Certainly, State and municipal securities are in constant and substantial competition with United States securities in the investment field, and the following statement from Mr. Justice Cardozo's dissenting opinion clearly recognizes

that illegal discrimination would result from any unfavorable treatment of United States securities, as compared with State and municipal securities (296 U. S. 127):

> "'Unfriendly discrimination' might be inferred if securities of every kind were excluded from the reckoning with the single exception of the obligations of the national government. That would be an extreme case, the conclusion hardly doubtful. Even though hostility were not so pointed as in the case supposed, *there might still be an invidious distinction if securities in substantial competition with evidences of indebtedness issued by the national government had been given a preferred position. Nothing of the kind appears.*" (Italics added)

(296 U. S. 129-130)

> ". . . The discrimination, as has been said, must be so marked as to justify the inference that it was unfriendly in design or *at the very least it must favor forms of investment that are in substantial competition with government securities.* . . ." (Italics added)

There has been no decision of this Court subsequent to its decision in the *Schuylkill Trust Company* case which contains the slightest indication of any retreat from its consistent position that any discrimination against United States securities, or the interest therefrom, will invalidate a state tax which gives rise to such discrimination. In fact, in every decision, in which this Court has had occasion to comment upon the factor of discrimination, the Court has given positive indication that the immunity of the Federal government and its agencies and instrumentalities from any sort of discriminatory state tax is to be safeguarded and perpetuated.

The opinion in *James* v. *Dravo Contracting Co.*, 302 U. S. 134, (1937), contains the following statement (p. 157):

> ". . . We concluded that a *non-discriminatory* tax upon the earnings of an independent contractor de-

rived from services rendered to the Government could not be said to be imposed 'upon an agency of government in any technical sense' and could not 'be deemed to be an interference with government, or an impairment of the efficiency of its agencies in any substantial way.' *Id.* pp. 524, 525." (Italics added.)

The following statement relative to discrimination was made in *Smith* v. *Davis*, 323 U. S. 111, 116 (1944):

> ". . . The assets of an independent contractor that are derived from the profits of a government contract stand in no preferred constitutional position so far as taxation is concerned. They too must bear their fair share of the tax burden. And as long as that burden is *non-discriminatory*, there is no basis for assuming that contractors will be any less willing to enter into construction contracts with the United States. . . ." (Italics added.)

It is significant in this connection to note that, even in the field of State income taxes affecting Federal employees, in which this Court has evidenced a tendency to narrow the tax immunity of the Federal government, the Court has nevertheless been careful to point out that there must be no discrimination against Federal employees.

In *Graves* v. *New York*, 306 U. S. 466 (1939), the question involved was whether a State had authority to impose a tax upon the income of an employee of the Home Owners' Loan Corporation. The tax was sustained because it was "a non-discriminatory general tax" (p. 487). Mr. Justice Stone, who wrote the opinion of the Court, said (p. 480):

> "The present tax is *a non-discriminatory tax* on income applied to salaries at a specified rate." (Italics added.)

Mr. Justice Frankfurter in his concurring opinion said (p. 488):

> ". . . . Since two governments have authority within the same territory, neither through its power to tax

> can be allowed to cripple the operations of the other. *Therefore state and federal governments must avoid exactions which discriminate against each other or obviously interfere with one another's operations.* These were the determining considerations that led the great Chief Justice to strike down the Maryland statute as an unambiguous measure of discrimination against the use by the United States of the Bank of the United States as one of its instruments of government." (Italics added.)

The attitude of this Court with respect to discriminatory state taxes affecting the Federal government was again evidenced in the recent case of *In re Kentucky Fuel Gas Corporation.* That case involved a tax imposed by the State of Kentucky upon postal savings certificates. Both the *Federal District Court,* 37 Fed. Supp. 625 (1941), and the *Circuit Court of Appeals,* 127 Fed. 2d 657 (1942), ruled that the tax was unconstitutional because it, in effect, discriminated against an instrumentality of the Federal government. The Circuit Court of Appeals made the following statement in this case (127 Fed. 2d, p. 660):

> "Recent Supreme Court cases repeatedly emphasize that the extension of the federal power to tax the income of state officials and vice versa, of state power to tax the income of federal officers, as well as the power to compel payment of taxes by persons who deal with governmental agencies, exists *only in case the tax is non-discriminatory.* . . . Obviously taxing postal savings certificates, and the deposits which they represent, five times as much as deposits in banks within the state, will cripple the extension, and within Kentucky possibly destroy the use of postal savings. If these deposits are to be taxed at such rate in comparison with ordinary bank deposits throughout the forty-eight states, the use of postal savings depositories may be practically terminated. It follows that this tax cannot be upheld." (Italics added.)

This Court dismissed an appeal and denied certiorari in this case, 317 U. S. 593 (1942).

Again, in the recent case of *Oklahoma Tax Commission* v. *Texas Company,* 336 U. S. 342 (1949), this Court definitely indicated that any state tax affecting the Federal government must be non-discriminatory in order to be valid. This case involved the question as to whether a lessee of mineral rights in Indian lands was subject to taxes imposed by the State of Oklahoma in the form of production taxes and excise taxes on petroleum produced on such lands. In the opening sentence of the Court's opinion, written by Mr. Justice Rutledge, it was said (p. 343):

> "The principal question is whether a lessee of mineral rights in allotted and restricted Indian lands is immunized by the Constitution against payment of *non-discriminatory* state gross production taxes and state excise taxes on petroleum produced from such lands. . . . . " (Italics added.)

This Court, in this case, overruled certain earlier decisions relating to State taxes affecting lessees of mineral rights in Indian lands, but in the course of its opinion it said (p. 363):

> ". . . . The taxes here are *non-discriminatory.* The respondents are 'private persons' who seek immunity 'for their property or gains because they are engaged in operations under a government contract or lease.' The functions they perform in operating the leases are hardly more governmental in character than those performed by lessees of school lands or, indeed, by many contractors with the Government. . . . . " (Italics added.)

In the very recent case of *New Jersey Realty Title Insurance Co.* v. *New Jersey,* 338 U. S. 665 (1950), this Court once again indicated that it has no intention of departing from the long established doctrine that United States securities may not be subjected to a State tax levied directly upon them or upon the interest derived from them, or even to a State tax which affects them only indirectly, if such

State tax is discriminatory. This case involved a tax levied upon the intangible personal property of a domestic corporation in the amount of fifteen per cent of the taxpayer's paid up capital and surplus, computed without deducting the principal amount of certain United States securities owned by the taxpayer and the accrued interest thereon.

This Court held the tax assessment to be invalid because, in practical operation, it imposed a tax *upon* United States securities in violation of Section 3701 of the Revised Statutes of the United States, which is merely a statutory expression of the constitutional requirement that United States securities be kept free from burdensome State taxation. (See *Home Savings Bank* v. *Des Moines,* 205 U. S. 503 (1907).) The Court stated that this conclusion as to the invalidity of the tax was inescapable, regardless of whether the tax was considered as an excise tax on net worth measured by corporate capital and surplus, or as a property tax on personal property based upon a valuation measured by capital and surplus.

The Court, in its opinion, laid particular emphasis upon the legislative purpose of Section 3701 of the Revised Statutes. In this connection it said (U. S., p. 675):

> "The result which is thus indicated is also required by legislative purpose, which we have found in § 3701, 'to prevent taxes which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit.' *Smith* v. *Davis,* 323 U. S. 111, 117 (1944)."

However, the Court made this further statement as to the operation of this tax (U. S., p. 675):

> "If, however, the assessment of $75,700 is viewed as if it were levied exclusively upon appellant's net worth remaining after deduction of government bonds and interest, the assessment would be *discriminatory* since it would be levied at the rate of over 79 per cent of ap-

pellant's assessable valuation of $94,936.87 rather than at the rate of 15 per cent prescribed by Sec. 54:4-22. Such increased rate of assessment would result solely from appellant's ownership of federal issues. In the *Gehner* case, *supra*, this Court held that Sec. 3701 was offended by a computation which allowed deduction of the full amount of the taxpayer's federal bonds yet at the same time pared down the net value of other allowable exemptions, to the taxpayer's disadvantage, solely because of such ownership of federal bonds. Consistently with the *Gehner* decision, we can only hold that Sec. 3701 is violated by an automatic increase in the rate of assessment applied to appellant's valuation after deduction of federal bonds." (Italics added.)

In view of the foregoing authorities, the Respondent respectfully submits that this case is not a proper one for review by certiorari in this Court, and that the Commonwealth's petition for a writ of certiorari should be denied.

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